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Currency Stabilization and World Recovery

BY JOHN C. deWILDE

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Currency Stabilization and World Recovery

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DURING the last few years world commerce has in large part been carried on without the assistance of a common monetary standard. Most currencies have ceased to maintain a fixed relation to gold, and even where such a relation has been retained or re-established it does not seem to be permanent. Considerations of purely domestic policy rather than of international factors have dictated the exchange rates of currencies. Exchange stability has had to yield before external pressure or the exigencies of domestic recovery programs.

More recently the question of restabilizing currencies and restoring the gold standard has again come to the fore. As early as May 13, 1935 the Secretary of the Treasury declared that the United States was no longer opposed to stabilization. Three days later the British Chancellor of the Exchequer replied that the re-establishment of exchange stability constituted "one of our ultimate objectives." Uncertainty concerning the future of the gold bloc, which increased this summer, may be dispelled in the fall. The French government is now making a supreme effort to avoid devaluation by slashing public expenditures and lowering the cost of living. In The Netherlands, parliament is at present blocking similar measures but cannot long avoid a definite decision. Switzerland, too, must soon face the necessity for further deflation in order to maintain the value of the franc. Should the gold bloc founder, the danger of competitive currency depreciation would increase and stabilization would become all the more imperative.

Considerable opposition to restoring the gold standard still exists. Some think the time is not yet ripe for definite action. The British government, for instance, has declined to take any steps until it can see "some prospect of stability of conditions after stabilization has been effected."[1] Others are entirely opposed to the return of the gold standard, except perhaps in a drastically revised form. They hold that monetary policy should be directed not toward keeping the national currency stable in relation to gold, but toward maintaining its domestic purchasing power and stabilizing internal economic activity.

THE GOLD STANDARD AND ITS OPERATION

The controversy regarding stabilization cannot be understood without a knowledge of the elementary principles underlying the operation of the international gold standard. Under this standard the currency of each country is the equivalent of a fixed amount of gold, and is convertible into this quantity on demand. With gold as the common denominator, the currencies of the world have a stable, fixed relation toward each other, the ratio being determined by the amount of gold which each currency unit represents. Thus if a unit in one country contains six times as much gold as the unit in another, the par rate of exchange between

1. Speech of the Chancellor of the Exchequer, May 16, 1935, *New York Herald Tribune*, May 17, 1935.

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the two currencies would be fixed at six to one. In the absence of such a common monetary standard currencies tend to fluctuate in terms of each other according to the factors of supply and demand. For instance, if at a given time remittances to foreign countries exceed receipts, then the demand for foreign currencies will be greater than the supply. The value of the domestic currency will consequently decline. Thus exchange rates will depend solely on the volume of international payments made for the purchase of goods, travel, freight, brokerage and banking services and for the transfer of capital—all the international transactions which go to make up what is commonly known as a balance of payments. Under the gold standard currency fluctuations resulting from shifts in supply and demand are confined within a very narrow range, for as soon as any one currency falls even a little below the par exchange rate determined by its gold content it becomes profitable to buy that currency, convert it into gold and ship this gold to foreign countries where it can be exchanged for other currencies. As long as currencies are freely convertible into gold and the exportation of this metal is unhindered, the degree to which they will diverge from par will be no more than the relatively small cost of transporting and insuring gold shipments. The upper and lower limits within which a gold currency will fluctuate are designated respectively as the "gold import" and "gold export" points—that is, the rate of exchange at which it becomes profitable either to import or export gold.

If the volume of payments received by a given country consistently exceeds the amount of outgoing payments, there is a danger that this country will gradually attract to itself all or almost all of the world's limited supply of monetary gold, thus leading to the ultimate breakdown of the international standard. The gold standard is supposed to supply a corrective for this possible tendency. In theory gold, as the basis of the currency, determines in the long run the volume of money outstanding in each gold standard country—not only the volume of cash as represented by coins and paper notes, but also the amount of bank credit or bank deposits subject to check by which such countries as the United States finance 90 per cent of their business transactions. Therefore, should gold flow into a country, the volume of money would tend ultimately to expand; and should gold flow out, a reverse tendency toward contraction would become manifest. As money becomes less or more plentiful, prices tend in turn to fall or to rise. When the price level rises following the importation of gold, exports become dearer and thus fall off in volume, while at the same time imports become cheaper and increase. This shift in the trade balance produces a greater demand for foreign currencies, checks the inflow of gold and may even reverse it.

From the international point of view the gold standard is held to have two advantages. First, by keeping currencies stable in relation to each other, it greatly facilitates the development of international trade and investments, thus enabling the world to profit materially from the greatest possible division of labor. Business men can sell abroad in the confident expectation that the money they will receive has a fixed unalterable value, and investors can place their money abroad with the assurance that capital and interest payments will not be diminished through marked currency fluctuations. Secondly, through the influence which gold flows are supposed to exert on the price level, and hence on exports and imports, the gold standard tends to bring about a more or less automatic equilibrium in the balance of international payments.

REQUIREMENTS OF THE GOLD STANDARD

For the proper functioning of the international gold standard a number of conditions are necessary. The first and fundamental requirement is that gold should be freely bought and sold at fixed prices by the monetary authorities and that it should move in and out of the country without impediment. The second is that gold flows should not be prevented from influencing the price level. The national monetary authority—usually the Central Bank—should direct its policy toward restriction of bank credit when a substantial amount of gold is lost, or toward expansion of bank credit or deposits when a considerable accession of gold takes place. The Central Bank may do this by changing its rediscount rate and, in certain countries such as the United States, by engaging in what are known as open-market operations. By raising the rate at which it will loan other banks money on their notes and collateral a Central Bank may compel these banks to curtail loans to their customers in order to reduce their own borrowings from the Central Bank or make them unnecessary. Conversely the Central Bank may make borrowing attractive and stimulate extension of credit by lowering its rediscount rate. To create additional credit facilities the Central Bank may in open-market operations buy government securities or bills of exchange, and the checks given in payment for these will find their way directly or indirectly to the banks where they will swell the amount of loanable funds. Similarly the Bank can curtail credit by selling government obligations or bills of exchange.[2]

Reasonable freedom of international trade is also indispensable to the efficient operation of the gold standard. Governments must not impede the readjustments in imports and exports which may become necessary to prevent large-scale gold movements. Creditor countries should above all enable debtors to discharge their obligations through the sale of goods and services rather than the exportation of gold. The latter should be used only to correct temporary disequilibria in the balance of payments. The gold standard cannot in the long run withstand the strain of sudden and drastic changes in the balance of international payments. International movements of capital, which have reached a substantial volume in modern times, must not be subject to sudden fluctuations. While the flow of foreign investments need not be large in order to insure the operation of the gold standard, it should be steady and directed toward countries whose capacity to repay is reasonably assured.

Before the World War the gold standard worked, on the whole, quite efficiently. While trade was by no means free, the degree of arbitrary interference with the international exchange of goods was slight. The policies of Great Britain provided the chief reason for the successful operation of the gold standard. As the leading and practically the only world financial center, London could impose on the system a unity of direction which was conspicuously lacking in the post-war years. Most of the world's trade was financed by London, and the clearing of international transactions through this money market obviated the necessity for large transfers of gold. London, too, controlled most of the international lending, and Great Britain, as the chief creditor country, adhered to the principles of free trade, so that debtors were not called upon to repay their loans in the form of gold.

DEFECTS OF THE POST-WAR GOLD STANDARD

The temporary suspension of the gold standard during the war was followed by a universal return to gold. The system, however, no longer functioned as well as in the pre-war years. Its defects can be ascribed to a number of factors.

I. Many countries returned to gold at rates which were economically unjustifiable. In relinking the pound sterling to gold at its pre-war level in 1925 the British government failed to take into account the generally weakened condition of British economy and the high costs of production under which British business men labored. Sterling became overvalued in relation to other currencies, thus making British costs and prices so high as to handicap Britain greatly in the competitive struggle for foreign markets. Other countries such as Italy and Norway also stabilized their currencies at excessively high rates. On the other hand, France stabilized in 1926 at a rate which seriously undervalued the franc, thus acquiring a competitive advantage for a number of years which enabled it to attract a disproportionately large share of the world's gold stocks.[3]

II. Governments and Central Banks showed an increasing reluctance to follow the rules of the gold standard and permit changes in gold holdings to influence the price level.[4] They were less concerned with the proper functioning of the international gold standard than with maintaining the internal stability of prices and incomes. Failure to keep price levels in the various countries in harmony with each other was in no small measure due to the greater rigidity of the economic system. The growing concentration of industry, the development of cartels, trusts and price-fixing arrangements, the accumulation of debt burdens, the organization of labor unions and increasing government intervention in business—all these greatly altered the free competitive system and made prices and costs of production much less flexible than in the pre-war period. Modification of prices in accordance with the rules of the gold standard became therefore much more difficult to achieve, and Central Banks naturally proved reluctant to bring about such changes for fear that they would unduly disturb domestic economy.[5] Thus Great Britain failed to deflate costs and prices sufficiently to compensate for overvaluation of the pound,[6] and the United States did not inflate following the enormous accessions of gold during the war and post-war years.[7]

III. The unity of direction which had formerly come from London was lacking. New York and Paris took rank with London as financial centers, and the three did not always work in harmony. Britain was displaced by the United States as the leading international lender. Unfortunately neither American banks nor American investors were as prudent and experienced as the British. Inspired by an unbounded op-

2. For a discussion of credit control by means of open market operations and rediscount rates, cf. Royal Institute of International Affairs, *The Future of Monetary Policy* (New York, Oxford University Press, 1935), pp. 69-73.

3. For a discussion of the failure of post-war stabilization, cf. Paul Einzig, *World Finance, 1914-1935* (New York, Macmillan, 1935), pp. 193-94; also T. E. Gregory, *The Gold Standard and Its Future* (New York, Dutton, 1932), p. 43.

4. Arthur D. Gayer, *Monetary Policy and Economic Stabilization* (New York, Macmillan, 1935), pp. 18-19.

5. *Ibid.*, pp. 34-44.

6. Only the presence of large foreign balances in London enabled Britain to continue on gold and concealed the fundamental weakness of sterling. Cf. *ibid.*, p. 20; also Gregory, *The Gold Standard and Its Future*, cited, pp. 53-54.

7. Mr. Lauchlin Currie points out that in only two years from 1921 to 1933 did the supply of gold and money (including bank deposits subject to check) change approximately directly and proportionally. Cf. *The Supply and Control of Money in the United States* (Cambridge, Harvard University Press, 1935), p. 107.

timism the American people engaged in a veritable orgy of foreign lending. American foreign investments soared from a total of $5,678,000,000 at the end of 1919 to $17,908,206,000 at the close of 1931.[8] Not only was much of this lending for unproductive purposes, but its volume fluctuated so much from year to year as to constitute a disturbing element in the balance of international payments. Unlike the United States, France did little lending on long-term account, but utilized its extensive surplus funds for short-term investment, largely in the form of balances in London and New York. The emergence of the United States and France as important creditors proved particularly unsettling because both countries were addicted to high tariffs which hindered debtor countries in repaying their obligations in goods and services.

IV. The character of international indebtedness underwent two important changes prejudicial to the gold standard. First of all, the war saddled Germany with enormous reparation obligations and the Allies with large debts owed to the United States. The discharge of these debts was especially difficult because they had been incurred for no productive purpose and the tariff policy of the United States impeded international transfer of the necessary payments. Secondly, the post-war period witnessed an extraordinary growth in the volume of short-term foreign debts. To this development a number of factors contributed.[9] In returning to gold after the war a number of countries adopted the so-called gold exchange standard, keeping all or part of their reserves not in the form of gold but in the form of balances in countries adhering to the gold standard.[10] The opportunities for profitable investment of short-term funds, particularly in Treasury bills and stock market loans, were also much greater than before the war. Moreover, the uncertain political and economic conditions created a decided preference for short-term investments which could be quickly liquidated. Funds were invested not only in the money markets of London and New York, but also in Central European countries, particularly Germany, where they were employed largely in lieu of long-term foreign capital. At the end of 1930 the international short-term indebtedness reached a total of no less than £2,800,000,000.[11] The volume and extreme mobility of this floating capital accounted perhaps more than any other factor for the ultimate breakdown of the gold standard. It proved incapable of withstanding the strains produced again and again by precipitate transfers of short-term funds whenever a political or economic crisis occurred.

8. Max Winkler, "American Foreign Investments in 1931," *Foreign Policy Reports,* February 3, 1932, p. 428.

9. For an analysis of these factors, cf. *The Future of Monetary Policy,* cited, pp. 152-54.

10. Even the Bank of France for a long time kept a substantial portion of its reserves deposited in New York and London. Cf. John C. deWilde, "French Financial Policy," *Foreign Policy Reports,* December 7, 1932.

ABANDONMENT OF GOLD

The world depression made it even more difficult to operate the gold standard successfully. Trade barriers multiplied, political and economic instability was accentuated, and investors of short-term capital rapidly lost confidence. The immediate circumstances leading to the abandonment of the gold standard are too well known to warrant detailed repetition. The political crisis caused by the ill-fated attempt to effect an Austro-German customs union and the financial difficulties of the Austrian *Creditanstalt* undermined confidence in Central Europe and precipitated a large-scale withdrawal of capital in the summer of 1931. The crisis soon communicated itself to Britain, which was not only heavily involved in Central Europe but faced perplexing economic difficulties of its own.[12] Credits advanced by the Bank of France and the Federal Reserve failed to stem the flight of funds from London. On September 21, 1931 the British government felt itself compelled to suspend the gold standard.[12a] All currencies of the British Empire except the Canadian dollar and the South African pound followed sterling immediately. The Scandinavian countries, dependent to a large extent on the British market, were practically compelled to follow suit. Japan went off gold in December 1931. Thus within a very short time more than half the world had abandoned the gold standard. The United States, despite several "raids" on the dollar, did not go off until March 1933, after the banking crisis had caused substantial withdrawals of gold. Even then departure from the gold standard was not the result of external compulsion but of a deliberate choice of policy. While gold stocks in the United States were sufficiently large to defeat any conceivable attack on the dollar, the Roosevelt Administration regarded a rise in internal prices essential to recovery and adopted a policy of depreciating the dollar as a means to this end.[13]

CHAOTIC CURRENCY CONDITIONS OF TODAY

Today the countries of the world may be classified roughly into four monetary groups. The first is the gold bloc, comprising those states which still adhere to gold at pre-depression parities and permit free exportation of this metal to maintain the value

11. Cf. "The Ebb and Flow of International Short-Term Funds," Midland Bank, *Monthly Review,* May-June 1935.

12. M. S. Stewart, "Britain's Financial and Economic Crisis," *Foreign Policy Reports,* November 11, 1931.

12a. Depreciation of the Australian and New Zealand currencies antedated that of the British pound.

13. For a convenient résumé of events leading to the suspension of the gold standard, cf. Einzig, *World Finance, 1914-1935,* cited, pp. 217-54.

of their currencies. It includes only France, Switzerland, The Netherlands and Poland.

The second consists of countries which, though not part of the gold bloc, keep their currencies more or less stable in relation to gold, either directly or indirectly. This group may again be split into a number of subdivisions. Some countries still maintain their currencies officially at the old parity even though this rate is more or less fictitious and the money is no longer convertible into gold. Germany, Italy, Hungary, Rumania, Albania, Bulgaria, Latvia and Lithuania are in this subdivision. Actually a large part of the export trade of most of these countries is carried on with depreciated currencies. Italy is sometimes still classed with the gold bloc, but after the imposition of a virtual foreign exchange monopoly in December 1934 the lira fell about 7 per cent below par. In another subdivision belong the countries whose currencies have been definitely allowed to depreciate by various degrees. Some of these, like the United States, Czechoslovakia, Austria, Belgium and Danzig, have revalued their currencies at new rates. After deliberately depreciating the dollar by repeatedly advancing the price of gold, President Roosevelt was authorized under the Gold Reserve Act of January 30, 1934 to devalue the dollar by from 40 to 50 per cent. On January 31 a Presidential proclamation revalued the dollar at 59.06 per cent of its former weight in gold. Czechoslovakia abandoned the old parity in February 1934 and devalued its currency by one-sixth in an effort to improve its export trade. Austria revalued its gold stocks on April 30 of the same year at a rate which recognized a depreciation of 21 per cent in the schilling. Belgium devalued the belga by 28 per cent on March 31, 1935, and Danzig revalued the gulden at 57.63 per cent of its old parity on May 2, 1935. With the exception of Austria, Czechoslovakia and Danzig, where strict control is still exercised over foreign exchange transactions, these countries may be said to have returned to the gold standard at new parities. Aside from the countries which have devalued, a number have depreciated currencies which they keep pegged to gold, or rather to some currency convertible into gold, such as the franc or the dollar. These include Yugoslavia, Greece, Spain, Mexico, Uruguay and Cuba.

The third monetary group is the sterling bloc, consisting of Great Britain and the countries which keep their money more or less pegged to sterling. To this bloc belong the Scandinavian countries, Finland, Estonia, Portugal, Japan, the British Dominions except Canada, and a number of South American states including Argentina, Bolivia, Brazil, Colombia and Paraguay. As will be seen from the accompanying table, the currencies of many of these countries have actually depreciated considerably more than sterling, even though they may now be maintained at an approximately fixed ratio to the British pound. This is particularly true of Japan and the states producing raw materials the price of which underwent an extraordinary slump during the depression. While all these currencies are more or less tied to sterling and thus stable in relation to each other, sterling itself fluctuates in terms of gold.[14]

The fourth and last group is a miscellany. It contains the few states and territories remaining on the silver standard: namely, China,[14a] Hongkong and Manchoukuo. Included are also a number of South American countries difficult to classify, and Canada, which has followed a policy independent of the United Kingdom but more closely approximating the course of the United States.[15]

DEPRECIATED CURRENCIES—JUNE 1935[16]

Country	*Percentage discount from gold parity*	*Country*	*Percentage discount from gold parity*
Czechoslovakia	16	Peru	50*
Venezuela	19*	Denmark	51
Austria	21	New Zealand	52
Yugoslavia	23	Australia	52
Belgium	28	Uruguay	54
United Kingdom	40	Greece	57
India	40	Bolivia	58*
Estonia	40	Spain	58
Portugal	40	Argentina	63
United States	41	Japan	66
Canada	41	Colombia	67
Cuba	41	Mexico	67
Sweden	44	Ecuador	72
Norway	45	Brazil	73
Finland	49	Chile	80*

*May 1935.

14. From March 1934 to March 1935 the British pound fluctuated as much as 10 per cent—a range which is all the more disturbing because sterling is the chief currency employed in the settlement of international payments. Bank for International Settlements, *Fifth Annual Report* (Basle), May 13, 1935, p. 8.

14a. China may be said to have abandoned the silver standard, at least temporarily, when in October 1934 the government imposed an export duty of 10 per cent on silver and supplemented this levy with an equalization charge "equal to the deficiency, if any, between the theoretical parity of London silver and a rate of exchange officially fixed by the Central Bank of China, after making allowance for the export duty." Cf. League of Nations, *Commercial Banks, 1929-1934* (Geneva, 1935), p. LXIII.

15. In classifying these monetary groups, the Fifth Annual Report of the Bank for International Settlements has been followed with some minor exceptions.

16. League of Nations, *Monthly Bulletin of Statistics,* July 1935.

THE EFFECTS OF DEPRECIATION

It is difficult to gauge accurately the effect of devaluation and depreciation on the economic situation of the countries affected. An analysis of the statistical evidence reveals that the members of the gold bloc are still economically stagnant while other countries seem to have made substantial progress on the road to recovery. In France, for example, the index of industrial production in the first quarter of 1935 fell below the average of the preceding depression years. In The Netherlands production has rallied only slightly since 1932; and in Belgium, which did not devalue until March 31 of the current year, the index for the first quarter of 1935 reached its lowest point. By contrast, in Britain production during the first three months of 1935 surpassed the 1929 level, and in Sweden 1929 figures were equaled as early as last year. A similar improvement has taken place in the other Scandinavian countries. Outside Europe the volume of industrial output during the first quarter of the current year exceeded 1932 figures by 40 per cent in the United States and 31 per cent in Canada.

Other figures tell a similar story. There has been little or no gain in employment within the gold bloc, while the increase in industrial activity has absorbed a considerable number of unemployed in other countries.[17] The number of bankruptcies, too, has shown a decided drop in states which have revalued or depreciated their money, but continues to be abnormally large in France, Switzerland and The Netherlands.[18]

To what extent does the divergence in monetary policy account for this disparity in the rate of recovery from the depression? Depreciation primarily affects foreign trade. By lowering the value of a currency in terms of other currencies the prices of exported goods are made cheaper while those of imported products become correspondingly dearer. Its two-fold effect is to discourage imports and facilitate exports.

It is difficult to discover whether this theory has worked out in practice. Probably exchange depreciation has stimulated domestic industry to some extent by discouraging competitive imports. In Britain the decline in sterling has reinforced the protectionist tariff adopted in 1931, and in Sweden the recovery of home industries is ascribed at least in part to the protective effect of currency depreciation.[19] On the other hand, the foreign exchange restrictions and import quotas adopted to prevent so-called exchange dumping and protect the value of currencies still stabilized at pre-depression levels has largely offset the stimulus imparted to exports by depreciation. Where exports have risen in volume, such increases have not taken place, as one would expect, in trade with the gold bloc, but with countries which have also allowed their currencies to decline.[20] Calculated in gold, the exports of states which have depreciated their money show little or no recovery. British, Norwegian and United States trade have declined in terms of gold to about the same extent as that of the countries which have maintained the par value of their money.[21] The foreign sales of Sweden, Canada and Japan show some slight increase.

It must not be concluded, however, that the effect of currency depreciation on exports has been negligible. While there has been no substantial rise in the gold value or even the volume of exports, the countries with depreciated moneys have received in terms of national currencies a much larger return on their foreign sales than the members of the gold bloc. Countries adhering to the old gold parity must in many cases sell their goods at prices far below the actual costs of production in order to meet competition on the world market. Exports for them have in large part become unprofitable. Such is not the case with the countries which have devalued or abandoned the gold standard. To them export prices appear relatively high in terms of their own currencies, particularly because depreciation has nowhere caused any considerable rise in internal prices and costs of production. They therefore find the export trade pretty profitable. The accompanying table reveals, for example, that British exports in terms of sterling yielded slightly more in 1934 than in 1931, while the value of Swedish and Norwegian exports, also calculated in national currencies, was well in excess of 1931 totals. Last year the dollar value of United States exports surpassed that of 1931 by fully one-third, and Japanese sales abroad brought more in terms of yen than in 1929. On the other hand, the value of exports from the gold bloc countries has fallen very far below 1931 levels.

17. *Ibid.*, June 1935, pp. 287-88.

18. NUMBER OF INSOLVENCIES

Monthly Average	*France*	*Netherlands*	*Switzerland*	*United Kingdom*	*U.S.A.*
1932	1,170	378	75	415	2,652
1934	1,254	387	82	326	1,105

Cf. *ibid.*, February 1935, p. 54.

19. Cf. Bertil Ohlin, "Economic Recovery and Labour Market Problems in Sweden," *International Labour Review*, May 1935.

20. Cf. Sir Henry Strakosch, "The Road to Recovery," *Supplement, The Economist*, January 5, 1935; also William Koren, Jr., "Britain's Economic Recovery: Prospects for Prosperity," *Foreign Policy Reports*, August 14, 1935, p. 147.

21. *Statistical Year-Book of the League of Nations, 1934-1935*, pp. 208-9.

INDEX OF EXPORTS IN TERMS OF NATIONAL CURRENCIES[22]

Country	*1929*	*1931*	*1932*	*1933*	*1934*
United Kingdom	100	53.5	50.0	50.4	54.3
Sweden	100	61.9	52.2	59.5	71.8
Norway	100	61.9	75.5	74.2	76.7
United States	100	45.9	30.5	31.9	40.7
Canada	100	51.1	41.5	44.5	54.6
Japan	100	53.2	64.8	87.0	101.8
France	100	60.7	39.4	36.7	35.5
Netherlands	100	65.9	42.6	36.5	35.7
Switzerland	100	64.3	37.1	34.6	34.6
Belgium	100	72.7	46.5	44.1	42.3
Italy	100	66.1	43.6	38.9	33.3
Germany	100	71.2	42.5	36.1	30.5

DEPRECIATION AND DOMESTIC RECOVERY

Exchange depreciation has not only affected foreign commerce, but has facilitated the restoration of a relationship between costs and prices which enables business enterprises to produce again at a profit, whether for the domestic or the foreign market.[23] In an economic depression wholesale prices generally tend to decline much more rapidly than the costs of production, which become inflexible to a large degree. As a result, the profit margin disappears, losses are sustained and business concerns forced to the wall. Deflation, once set in motion, soon becomes an almost endless downward spiral, since the reduction of costs seems never to catch up with the continuous fall in prices. One business failure precipitates another, and the resulting unemployment tends to decrease economic activity still further. With declining prices private and public debts also become progressively more burdensome.

The countries which left the gold standard or devalued were able to avoid further deflation and its consequences. Prices remained stable or tended upward not only because there was no longer any necessity for lowering them in conformity with trends in other states but also because imported goods became dearer. If many nations, including the producers of raw materials, had not allowed their currencies to depreciate at about the same time and prices had not dropped further in the countries still clinging to gold, abandonment of the gold standard would have produced a more pronounced rise in prices than actually took place. In Britain and Sweden wholesale price levels even declined slightly in 1932 and 1933, but recovered again in the following year. The monetary authorities in these two countries directed their efforts toward the maintenance of price stability. In the United States, on the other hand, the government deliberately set out to raise prices through lavish public expenditure and through such measures as the NRA and the AAA. In Japan, too, unbalanced budgets were instrumental in bringing about a substantial rise in prices. The mere fact that abandonment of the old exchange parities checked the decline in wholesale prices and brought about a rise in some cases would not have been beneficial if costs of production had increased correspondingly. Such, however, has not been the case. Production costs, as reflected by the cost of living, have in most cases remained stable or declined slightly, and where wholesale prices have risen costs have lagged behind. Thus the countries which permitted their currencies to depreciate avoided a progressive accentuation of the maladjustment between costs and prices and paved the way for the re-establishment of a more economic ratio between the two.

INDICES OF WHOLESALE PRICES AND COST OF LIVING[24]

(*W.P.—Wholesale Prices: C.L.—Cost of Living*)

Country		*1929*	*1931*	*1932*	*1933*	*1934*
United Kingdom:	W.P.	131	100	97.5	96.8	100
	C.L.	111.7	100	97.3	95.2	95.9
Sweden:	W.P.	126.1	100	98.2	96.4	102.7
	C.L.	107.0	100	98.7	96.2	97.5
United States:	W.P.	130.5	100	88.8	90.4	102.7
	C.L.	115.3	100	90.2	88.9	93.2
Japan:	W.P.	143.7	100	105.3	117.3	116.1
	C.L.	133.8	100	101.0	107.4	109.7
France:	W.P.	124.9	100	85.2	79.4	75.0
	C.L.	97.7	100	92.4	91.4	90.6
Netherlands:	W.P.	146.4	100	81.4	76.3	80.4
	C.L.	111.2	100	93.3	92.3	92.7
Switzerland:	W.P.	128.7	100	87.5	82.9	81.9
	C.L.	107.3	100	92.0	87.3	86.0
Italy:	W.P.	140.6	100	90.6	82.7	80.7
	C.L.	112.4	100	96.5	92.6	88.7
Germany:	W.P.	118.0	100	87.4	83.8	88.3
	C.L.	113.2	100	88.9	86.7	88.9

THE PLIGHT OF THE GOLD BLOC

Currency depreciation has taken place at the expense of the countries adhering to gold at pre-depression parities. When Great Britain abandoned the gold standard in 1931, its action depressed

22. Calculated from figures in *Statistical Year-Book of the League of Nations, 1934-1935*, pp. 202-7.
23. Bertil Ohlin, "International Trade and Monetary Policy," *Index* (Svenska Handelsbanken), July 1935.
24. Calculated from figures in *Statistical Year-Book of the League of Nations, 1934-1935*, pp. 227-29.

prices in all countries which did not follow its example. As more currencies followed sterling the pressure on the gold bloc increased. The sudden abandonment of the gold standard by the United States in March 1933 precipitated another deflation of prices in the remaining countries of the gold bloc just when the economic situation was beginning to show some signs of improvement.

The countries which refused to abandon gold and permit their currencies to depreciate could adopt one of two courses. If they desired to maintain their position on world markets, they were faced with the necessity of cutting prices and, above all, costs of production. If they wanted to avoid the evils of deflation and either raise or maintain price levels, they could do so only at the expense of instituting the strictest control over all commercial transactions with other countries and progressively isolating themselves economically from the rest of the world.

The gold bloc countries have on the whole displayed a preference for the first course. Up to the present, however, they have not deflated with sufficient ruthlessness to bring their cost and price levels into harmony with those of countries whose currencies have depreciated. Deflation has entailed sacrifices which have met with ever greater resistance. In private enterprise wage cuts have been stubbornly opposed by organized labor, while capital charges, rents and other items in the cost of production have proved difficult to reduce. Drastic retrenchment in public expenditure has been almost impossible. In view of the tense international situation, appropriations for national defense have increased rather than decreased. The depression has made it necessary to spend larger sums in assisting distressed industries and banks and relieving unemployment. Attempts to reduce the salaries of government employees or curtail military and civil pensions and social insurance payments have aroused determined opposition. Discontent has grown, and strikes, demonstrations and even riots have taken place.

The dissatisfaction aroused by deflationary measures has sharpened political antagonism and contributed directly to government instability, especially in France.[25] Conservative groups have been the protagonists of drastic economy, while the radicals have bitterly opposed deflation at the expense of salaried employees, wage-earners and holders of pensions. The issue has usually been fought out over the budget. In France, for example, no less than five ministries have been defeated on budgetary questions since the end of 1932.[26] Usually each political crisis undermined confidence in the future of the currency and produced a temporary run on the country's gold stocks.

Repeated efforts to reduce government expenses and balance budgets have so far failed, largely because economies have been offset by further declines in tax receipts or by emergency appropriations. In France the Doumergue government obtained special powers in February 1934 to reduce public expenditure, and economies of over three billion francs were effected; but by the spring of the following year the Flandin Cabinet again faced a combined budget and railway deficit of over 10 billion francs.[27] Not until after two ministries had been defeated and almost 12 billion francs in gold had been withdrawn from the Bank of France in the space of ten weeks did the new government of Pierre Laval obtain special budgetary powers from the Chamber on June 8, 1935. In what was generally regarded as a last determined effort to stave off devaluation of the franc this government on July 17 issued a series of decrees designed to provide savings and new revenues totalling almost 11 billion francs.[28] A flat reduction of 10 per cent was effected in all public disbursements, including payments for salaries, pensions and interest coupons on government obligations. Simultaneously the government for the first time made a direct attack on the high cost of living, ordering reductions in house and apartment rents below a specified minimum, in bread and coal prices, and in public utility rates. The effect of these decrees should determine to a large extent whether France can remain on gold at the present parity.

France's difficulties are typical of those experienced by Switzerland and The Netherlands—and by Belgium before it devalued the belga. In Switzerland little or no compression of public expenses has taken place.[29] Not only has there been vigorous opposition to retrenchment, but the economic crisis has produced a steady growth of subsidies to agriculture, the tourist industry, unemployment insurance funds and the like. In The Netherlands the government has also been unable to make ends meet. While the ordinary budget has been reduced, financial assistance in the form of loans or direct subsidies has had to be extended on a considerable

25. Cf. John C. deWilde, "Political Ferment in France," *Foreign Policy Reports,* July 18, 1934.

26. The ministries, together with the date of their resignations, are: Paul-Boncour, January 28, 1933; Daladier, October 23, 1933; Sarraut, November 23, 1933; Flandin, May 31, 1935; and Bouisson, June 4, 1935.

27. For a survey of the development of the French budget and the numerous economy measures, cf. "Le Budget Français," *L'Europe Nouvelle,* June 8, 1935.

28. *Le Temps,* July 18, 1935.

29. Cf. "La Situation Financière de la Confédération Suisse," Société de Banque Suisse, *Bulletin No. 3,* May 1935.

scale to agriculture and shipping.[30] Parliament, moreover, rebelled in July 1935 against a new economy bill introduced to bridge a deficit of 77 million guilders by further reductions in the salaries and pensions of civil servants and the appropriations for education, public works and social services.[31]

GERMANY'S COURSE

While the gold bloc has sought with only limited success to force down prices and costs in an effort to offset the effect of currency depreciation abroad, others have abandoned all attempts at deflation without, however, permitting any pronounced depreciation of their currencies. This course has been pursued primarily by Germany, and to some extent by Italy. After undergoing drastic deflation until the end of 1932, Germany under the National Socialist régime embarked on a policy of stimulating economic activity through large-scale expenditures for public works and rearmament. While this policy proved successful in increasing industrial production and employment, it also had very unfavorable repercussions on German economy. The resulting rise in costs and prices accentuated the decline in exports and made it increasingly difficult for Germany to obtain the raw materials necessary for its economic life. Exchange restrictions were tightened, imports drastically rationed and domestic substitutes for foreign raw materials developed. Germany has gradually drifted into comparative economic isolation, and this very process has still further increased the disparity between German and foreign price levels.

The situation has been only partially ameliorated by the use of depreciated "blocked marks" in financing exports and the tourist trade. These marks represent foreign funds frozen in Germany by the imposition of foreign exchange restrictions and the institution of a transfer moratorium affecting almost all foreign debt payments. Since blocked marks are not convertible into gold and their use even within Germany is greatly limited, they have depreciated in value, and the German government has taken advantage of this depreciation to permit their employment, under certain restrictions, as payment for German exports and for expenses of foreign tourists in Germany. The use of these marks, however, has been insufficient to compensate for the competitive advantages obtained by other countries through outright currency depreciation.[32] In the summer of 1935 Dr. Schacht, Minister for Economics, therefore secured the adoption of a plan creating a direct export subsidy fund of about one billion marks to be raised largely by levies on the domestic sales of industrial enterprises.[33]

Adherence to the gold value of the mark has not only imposed on Germany a large degree of economic isolation, but has also diverted German foreign trade into uneconomic channels. Foreign exchange restrictions have been necessary to protect the external value of the currency, and these in turn have led to the conclusion of so-called clearing arrangements with many countries, particularly in Europe. These clearing agreements provide that payments for imports shall be made from the proceeds of exports, thus obviating the necessity for the international transfer of money and keeping alive a minimum of foreign trade in spite of exchange restrictions. Through the process of clearing, however, German trade with European countries has tended to balance. Germany, which formerly sold much more to Europe than it bought and used the surplus for the purchase of raw materials in overseas countries, now has only a small export excess with Europe and has therefore been compelled to curtail sharply its imports from other continents. This has further weakened German economy.[34]

Italy has followed a policy somewhat different from that of the gold bloc, although not so decidedly expansionist in character as that pursued by Germany. It adhered to a deflationary course throughout most of the depression, but later embarked on extensive expenditures for public works. This proved to be a strain on the lira, and in December 1934 the government was forced to impose strict control on all foreign exchange transactions and mobilize all privately owned foreign assets in order to maintain the external value of the currency.[35] Even so, some slight depreciation has taken place. In the summer of 1935, moreover, foreign purchases necessitated by military preparations for the Ethiopian campaign subjected the lira to further pressure. The loss of gold led the Italian government on July 22 to suspend the requirement stipulating that a 40 per cent reserve in gold and

30. H. A. Kaag, "Brief Survey of Measures taken in the Netherlands to Combat the Effects of the Economic Crisis," Amsterdamsche Bank, *Financial and Economic Review*, January 1935.

31. *New York Times*, July 22-27, 1935.

32. Cf. John C. deWilde, "Germany's Trend toward Economic Isolation," *Foreign Policy Reports*, November 7, 1934.

33. Cf. *The Economist*, May 11, 1935, p. 1069; June 1, 1935, p. 1246; and July 6, 1935, p. 13.

34. For an analysis and searching criticism of clearing agreements, cf. League of Nations, *Enquiry into Clearing Agreements* (Geneva 1935).

35. Cf. Einzig, *World Finance, 1914-1935*, cited, pp. 267-8; also Vera M. Dean, "The Economic Situation in Italy," *Foreign Policy Reports*, January 30, 1935.

gold exchange be held against notes and other sight liabilities.[36]

FUTURE OF THE GOLD BLOC

Despite the economic and social difficulties caused by the maintenance of currencies at pre-depression gold parities, considerable opposition to depreciation or devaluation continues to be manifest. Even radicals who propose to raise wages and embark on lavish expenditure for public works are loath to concede that their program entails currency devaluation. Three arguments are usually advanced against impairing the value of the currency. First of all, the high exchange rate makes it possible to import raw materials very cheaply. This advantage is to some extent offset by the high internal costs of converting raw materials into finished products. Second, the experience of other countries demonstrates that currency depreciation does not produce any substantial increase in exports. While it is true that trade barriers may prevent the actual volume of exports from rising markedly, this argument ignores the fact that manufacturers and shippers would be able to obtain better prices for their goods and thus again find the export trade profitable. Third—and this is probably the most important consideration—it is feared that devaluation may produce inflation. The Germans, French and Italians, for example, have all experienced inflation in varying degrees and are not anxious to have their savings wiped out again in whole or in part. Their governments fear that outright depreciation may shake popular confidence in their currencies, produce a flight of capital into tangible property and cause prices to soar. The validity of this argument cannot be conclusively tested, since it is well-nigh impossible to foresee the exact nature of popular reaction to the abandonment of the gold standard. The experience of Belgium, however, is instructive in this respect.

Belgium, more dependent on foreign trade than the other gold bloc countries and handicapped by an illiquid banking system, devalued the belga by 28 per cent on March 31, 1935. The Belgian people, who had undergone a post-war inflation similar to the French, were at first seized by a buying panic. Retail prices began to rise steeply, but prompt intervention by the government checked the rise at its inception. Confidence in the revalued belga was strengthened, funds began to flow back from abroad, and the National Bank was able to lower its rediscount rate. Although the cost of living increased but little, wholesale prices rose, thus encouraging industrial production and reducing unemployment.[37]

It is uncertain whether the remaining members of the gold bloc will follow Belgium's example. If they can hold out long enough, prices and costs in countries with depreciated currencies may rise sufficiently to attain equilibrium with those in the gold bloc. Meanwhile, confidence in the future of the Swiss and French francs and the Netherlands guilder will not be strong—at least so long as economic conditions fail to improve and the political and social unrest attendant on deflation continue. Any unfavorable political or economic event may provoke a flight of domestic and foreign capital which will tear the currencies from their gold moorings. Although gold stocks in each of the three countries seem very large,[38] they are not proof against a prolonged drain occasioned by an absolute loss of confidence. Moreover, each member of the gold bloc has its own particular weakness. France is burdened with a highly unstable political situation. The Netherlands parliament is rebelling against deflation, and the guilder has been further weakened by devaluation of the belga which has greatly injured the shipping interests of Rotterdam and Amsterdam.[39] In Switzerland the banking system is vulnerable, for bank assets are to a large extent tied up in frozen foreign credits, real estate mortgages and long-term loans to domestic industry.

STABILIZATION— CONDITIONS AND METHODS

The chaotic monetary conditions prevailing throughout the world are not conducive to economic recovery. The benefits of devaluation and depreciation have been obtained largely at the expense of economic stagnation in the countries still clinging to gold. Uncertainty concerning the future of currencies has retarded the revival of international trade and foreign investment. To maintain the value of currencies and guard against exchange dumping, new trade barriers have been erected in the form of quotas and foreign exchange restrictions. No less than thirty-one countries have instituted control over foreign exchange dealings.[40] These restrictions, in turn, have produced many clearing

36. *New York Times*, July 23, 1935.

37. *The Economist*, June 1, 1935. For a discussion of the circumstances leading up to devaluation of the belga, cf. Charles Roger, "A 'New Deal' for Belgium," *Foreign Affairs*, July 1935.

38. At the end of July 1935 the ratio of gold reserves to sight liabilities was 74.7 per cent for the Bank of France, 63.8 per cent for the Netherlands Bank and 81.2 per cent for the Swiss National Bank.

39. *The Economist*, May 4, 1935.

40. Cf. International Chamber of Commerce, *Monetary Problems*, Paris Congress 1935, Document No. 3.

and barter agreements, the effect of which has been to promote the bilateral canalization of international trade and curtail the volume of triangular and multilateral trade which has in the past enabled the world to profit from the greatest possible division of labor.

INTERNAL VS. EXTERNAL STABILITY?

Short of a perpetuation of the existing situation, which seems unlikely, the world faces two alternative courses. The first is restabilization of all currencies at fixed exchange rates, which would involve a return to the gold standard, perhaps in modified form. The second is universal abandonment of the gold standard and adoption of national monetary policies which would be directed toward the attainment of domestic economic stability rather than the maintenance of external currency values.

The proponents of the second course oppose restoration of the gold standard primarily on the ground that it is incompatible with internal economic stability. The principles of the standard, they point out, require that domestic price levels be readjusted upward or downward in accordance with an inflow or outflow of gold. This necessitates an expansion or curtailment of the supply of money, particularly bank credit, and so engenders an inflationary or deflationary cycle which may well lead to economic depression. It has been pointed out before that costs of production have become rigid to a very large extent, so that when prices are reduced costs lag behind. Consequently profits tend to vanish, business failures occur and unemployment rises. Moreover, prices, too, show varying degrees of inflexibility. At one end of the scale are business concerns, particularly large industrial corporations, which can and do maintain their prices at a relatively high level by drastically curtailing their output. At the other end are the farmers who, through force of circumstance, continue to produce in almost undiminished volume, and as a result must suffer a proportionately larger reduction in prices.[41] Deflation therefore creates a disturbing maladjustment in the price structure and the distribution of national income. It also works hardships on debtors who see the burden of their indebtedness increase in terms of lower prices and incomes. Conversely, price inflation resulting from the acquisition of gold may be equally undesirable for the stability of domestic business. It may stimulate a speculative boom which will lead to economic collapse. In fact, the rules of the gold standard may require a rise in the price level at a time when reduction of costs following improvements in production dictates lower prices as a sounder policy.[42]

Protagonists of the gold standard do not concede that external exchange stability cannot be reconciled with the attainment of a stable domestic economy. In their view gold movements ordinarily bring no sudden and disturbing price changes but affect the price level very gradually, thus giving business time to adjust itself. If accessions or losses of gold are large, they may well have an adverse inflationary or deflationary effect, but the fault then lies not so much with the gold standard as with the government authorities who bring about or fail to prevent a disequilibrium in the balance of international payments. Gold movements disturbing to domestic business can be minimized provided governments exercise a prudent control over the balance of payments.

Those who favor returning to gold also doubt the feasibility of managed currencies. The employment of monetary policy to achieve domestic business stability requires not only agreement on the criterion of stability, but also considerable prescience and ability on the part of those charged with the conduct of this policy. Conservatives question whether these prerequisites can be satisfied. Some advocates of managed currencies would aim at a general stability of prices. Others regard the maintenance of a proper ratio between costs and prices as more important. Still others would make preservation of a balanced relationship between flexible and inflexible prices the essential task. Even if agreement on the goal were reached, the monetary authorities would still face the difficult assignment of analyzing and properly weighing all the complex factors in the economic life of the country. If they are to be guided by price indices, what goods and services should these indices include and what importance should be given to each?[43] If the

41. The varying flexibility of prices and its implications for monetary policy have recently been analyzed by the Financial Adviser of the Secretary of Agriculture. An examination of 747 items in the Bureau of Labor Statistics' wholesale price index over the period 1926-1933 revealed that 191 items changed less than once every ten months, 183 more than once every ten months but less than once in four months, 192 between one and three times every four months, and 181 at least three times in four months. Cf. Gardiner C. Means, *Industrial Prices and their Relative Inflexibility*, 74th Congress, 1st Session, *Senate Document No. 13*.

42. Thus in the United States during the 1920's the progress of industrial technique really required a declining price level, while the large gold stocks acquired by this country during and after the war called for a credit expansion conducive to higher prices. A continued "cheap money" policy would, however, have accentuated the 1928-1929 boom. In fact, monetary conservatives generally hold that the cheap money policy adopted by the Federal Reserve Banks in 1927 laid the foundation of the boom that followed. Cf. Gayer, *Monetary Policy and Economic Stabilization*, cited, pp. 21-22, 129-31.

cost-price ratio is to be maintained, how can the baffling problem of determining costs of production be solved? The authorities must be able not only to analyze economic data, but foresee the development of serious maladjustments in order to anticipate them by timely intervention. It may be doubted, moreover, that they would be permitted to follow their own judgment in complete independence of political pressure.

DISADVANTAGES OF FLUCTUATING EXCHANGE RATES

What would be the effect of managed currencies on international economic relations? Under a paper standard the external value of a currency would fluctuate in accordance with supply and demand. The exchange rate would tend to seek the level at which the debits and credits on the international payments' account would balance. Thus varying exchange rates would have the advantage of promoting an automatic equilibrium of international payments, while under the gold standard a fundamental disequilibrium can be maintained for a long time by the shipment of gold.[44] There is no guarantee, however, that exchange would be allowed to seek its own level. Every country would probably be tempted to make an illusory bid for trade advantages by depressing the external value of its currency below the true equilibrium rate. Thus the danger of competitive depreciation would arise. Moreover, fluctuating currencies would be at the mercy of waves of speculation.[45]

Unstable exchange rates might bring about progressive economic isolation.[46] Without certainty as to the future course of currencies, the international sale of goods and the transfer of capital would be attended with great risk. To be sure, the risk might be minimized by purchasing forward exchange, or contracts to sell foreign exchange at a specified rate and definite date in the future, but the forward exchange market fails to function well just when the relative values of currencies are most uncertain.[47] Moreover, the forward exchange rate cannot itself be prevented from fluctuating, so that any manufacturer or farmer producing for the foreign market could never be certain at what price he would ultimately be able to sell his goods. Continual changes in the external value of currencies would also entail marked fluctuations in the volume of imports and exports, and thereby interfere with the attempts to achieve internal economic stability. In self defense, countries would either stabilize exchange rates or impose quantitative limitations on trade. In the latter event the natural tendency would be to restrict imports to the indispensable minimum.

STABILIZATION AS A STIMULUS TO ECONOMIC RECOVERY

Currency stabilization would bring many advantages from the international point of view. It would pave the way for a revival of international trade by re-establishing confidence in the future course of exchange rates and by removing barriers set up as a result of the present chaotic monetary situation. By stimulating trade it would facilitate the resumption of payments on foreign loans, many of which are now in default. The restless peregrination of short-term funds would tend to diminish, and long-term foreign investment would be encouraged. The latter development might seem a dubious advantage, for considerable losses have been sustained on capital investments abroad,[48] and foreign lending has generally been discredited in the popular mind. Foreign loans also bear the taint of imperialism. It may be questioned, however, whether the reaction has not gone too far. Underdeveloped countries lacking in capital might find it to their interest to borrow and richer countries would find it advantageous to lend, provided investments are not beyond the borrowers' capacity to repay and do not subject them to undue foreign control. Prudent foreign lending should make it possible to develop the world's productive capacity to the fullest extent. As a number of British economists have said: "The problem is not that of deciding whether to lend, but of seeing how to lend wisely."[49]

PREREQUISITES TO STABILIZATION

If currency stabilization is adopted as an objective, the question arises whether conditions today are such as to insure the proper functioning of

43. For a discussion of the puzzling problem of compiling a satisfactory price index, cf. *The Future of Monetary Policy,* cited, pp. 53-54.

44. L. L. B. Angas, *The Problems of the Foreign Exchanges* (New York, Knopf, 1935), pp. 70-74.

45. Cf. Lionel Edie, *Dollars* (New Haven, Yale University Press, 1934), pp. 74-75.

46. Cf. John H. Williams, "Monetary Stability from an International Point of View," *The American Economic Review, Supplement,* March 1935.

47. Cf. Gregory, *The Gold Standard and Its Future,* cited, p. 10.

48. Out of a total of $5,469,085,190 outstanding in dollar bonds issued or guaranteed by foreign governments or political divisions thereof, $1,825,375,250 or one-third were in default as to interest payments on December 31, 1934. Cf. Foreign Bondholders Protective Council, *Annual Report 1934,* p. 225. The income from United States foreign investments dropped from $979,000,000 in 1929 to $461,000,000 in 1932. Cf. U. S. Department of Commerce, *The Balance of International Payments of the United States in 1932,* pp. 34-35.

49. Cf. *The Future of Monetary Policy,* cited, p. 160.

the gold standard. The answer cannot be categorical. A number of favorable factors may be listed.

I. Fears that the scarcity of gold would preclude a universal return to the gold standard have been largely dispelled. Today the supply of monetary gold is generally regarded as quite ample for a long time to come. The depreciation of currencies has not only increased substantially the value of existing gold stocks, but also stimulated production by raising gold prices. When the dollar was revalued, the monetary gold reserves of the world's central banks and governments increased from $11,951,000,000 to $20,229,000,000.[50] Gold production rose from 19,585,000 ounces in 1929 to no less than 27,107,000 ounces in 1934.[51] In addition, under the stimulus of high prices, gold to the value of 3,437 million Swiss francs has issued from the hoards of the Far East in the last four years.[52] Since 1930, monetary stocks have been enlarged by about 22 per cent, or some 125 million ounces.[53]

The enlarged value of world gold stocks has not entirely removed the complaint that the supply is not properly distributed. A number of Central European and South American countries do not have a sufficient amount to enable them to return to the gold standard. The gold reserves of Germany have been almost entirely dissipated during the depression. The United States, on the other hand, added more than $1,100,000,000 to its large reserves in 1934 as a result of the increase in exports and the repatriation of capital following devaluation of the dollar.[54] If currencies are to be stabilized, the inadequate gold supplies of certain countries will need to be replenished. This could be accomplished either by granting loans, which would probably prove unpopular, or by stabilizing the currencies of these countries at a relatively low level so as to enable them to acquire gold through the medium of a favorable balance of trade.

II. War debts and reparation payments have been practically cancelled and the volume of short-term indebtedness greatly reduced. While final settlement of the war debt and reparation questions is sometimes made a prerequisite to stabilization, particularly in Britain,[55] few people have any illusions about the resumption of payments on these political debts. The reduction in international short-term debts from 70 to 30 billion Swiss francs since the end of 1930[56] should also make it easier to operate the gold standard successfully.

III. The conviction has grown that there can be no complete recovery from world depression unless measures for domestic business revival are ultimately complemented by steps to restore international trade to its previous volume. In the world as a whole, production has recovered a substantial part of its depression losses; yet the quantum of international trade has risen but little above the record low reached in 1932.[57]

On the other hand, conditions which would tend to prejudice successful operation of the gold standard still exist. A few of these may be enumerated.

I. Political and economic conditions throughout the world are very unstable. International relations are characterized by tension and conflict, so that it is very doubtful whether the degree of cooperation essential to the proper functioning of the gold standard can be achieved.

II. There is no definite assurance that currency stabilization would be followed by a general relaxation of trade restrictions. Since the present chaotic monetary situation has itself produced new obstacles to the flow of goods and capital it may be idle to require, as the British government does,[58] that stabilization should be preceded by reduction of trade barriers and revival of foreign lending.[59] Yet it would be equally futile to return to the gold standard on a permanent basis unless there is some prospect that the governments of the world will gradually abandon or modify prevailing policies of economic nationalism. Although the value of freer international trade is receiving more widespread acknowledgment, the forces making for autarchy are still strong. Vested economic interests nurtured behind tariff walls bring powerful pressure to bear against liberalization of restrictions; and the uncertain international political situation strengthens rather than weakens tendencies toward economic self-sufficiency.

III. The future development of price levels, particularly in the United States, remains unpredictable. Once currencies are stabilized, prices and costs in the various countries affected must be kept in approximate equilibrium. Should American prices rise too rapidly, they might easily upset previously determined exchange rates. At present the ultimate effect of lavish public spending and other price-raising experiments in the United States cannot be accurately foretold. Political pressure for currency expansion and the attempt of the Administration to centralize the direction of bank credit policies in the Federal Reserve Board have also increased the fear of inflation in conservative circles.[60]

50. Cf. *Federal Reserve Bulletin*, June 1934.

51. Bank for International Settlements, *Fifth Annual Report*, cited, p. 14.

52. *Ibid.*, p. 15.

53. Midland Bank, *Monthly Review*, April-May 1935.

54. Cf. Bureau of Foreign and Domestic Commerce, *The Balance of International Payments of the United States in 1934*.

55. Sir Henry Strakosch, "The Road to Recovery," *The Economist, Supplement*, January 5, 1935.

56. Bank for International Settlements, *Fifth Annual Report*, cited, p. 31.

57. The quantum index of world trade rose from 73.9 in 1932 to 77.1 in 1934—an increase of only 4.3 per cent. Cf. League of Nations, *Monthly Bulletin of Statistics*, June 1935. During the same period the production index increased 24 per cent—from 76.8 to 95.2. Cf. *Vierteljahrshefte zur Konjunkturforschung*, Heft 2, Teil B, 1935, p. 53.

58. Speech of the Chancellor of the Exchequer, May 16, 1935, *New York Herald Tribune*, May 17, 1935.

THE PROBLEM OF FIXING NEW EXCHANGE RATES

If governments decide to stabilize, they face the difficult task of determining new exchange parities. The simplest course undoubtedly would be to let each country decide for itself the level at which it wants to return to gold. Each government would be tempted, however, to revalue its currency at too low a rate, and the net effect might be the establishment of a series of arbitrary parities which would soon bring about another breakdown of the gold standard. The best policy would therefore be to stabilize at rates agreed upon through international consultation.

The difficulty of determining new exchange levels lies in the absence of any accurate scientific method. In theory stabilization should take place at rates which would obviate the necessity for large gold transfers and bring about an approximate equilibrium between the credits and debits in each country's balance of international payments.[61] The determination of these rates requires a prediction of the volume of goods, services and capital that will move from country to country in the next few years. To forecast the probable volume of capital movements will be particularly difficult and will necessitate a detailed analysis of the creditor or debtor position of the various countries. To gauge the future flow of imports and exports, which gives rise to the major part of supply and demand in the foreign exchange markets, it will be necessary to calculate the relative differences in costs of production and prices. Probably the only way of accomplishing this is to assume that costs and price levels in the countries of the world were approximately in equilibrium with each other at a certain time—say, 1929—and then to figure the degree of divergence in terms of gold since that time. It can then be estimated to what extent cost and price structures, and presumably currencies, are out of line with those of a given country. In the absence of any index of costs, wholesale prices may be used as the basis of calculation. If this method is followed, it will be discovered that during the first third of 1935 the leading foreign currencies were overvalued or undervalued in relation to the dollar as follows:[62]

Currency	*Percent of Overvaluation: + Undervaluation: —*
Pound sterling	+ .25
French franc	+ 9.20
Dutch guilder	+ 5.20
Italian lira	+20.50
German mark	+48.50
Japanese yen	— 9.20

These percentages are only very rough approximations and can be no more than guideposts in the selection of new parities. It is likely that they underestimate the overvaluation of the franc and guilder, since in the gold bloc costs have generally not declined as rapidly as prices. Account must be taken of the fact that wholesale prices do not always reflect costs accurately and must therefore be checked, if possible, by detailed examination of comparative wage trends and other cost items. Finally, changes in relative costs and prices are not the only factors that influence the international exchange of goods. Alterations in tariff rates and other trade restrictions, as well as changes in demand, must be considered.[63]

PROVISIONAL STABILIZATION

Most authorities agree that restoration of a free international gold standard should be preceded by a period of provisional currency stabilization.[64] During this time it would be possible to ascertain whether the conditions essential to proper functioning of the gold standard could be realized. There would also be an opportunity to test the feasibility of the new exchange rates and to alter them after a certain period, should that prove necessary. The proposed trial stabilization agreement would probably best be confined to the dollar, sterling and the franc, and the other currencies left free to adjust themselves accordingly. Possibly, however, France might wish some assurance regarding the future course of the German mark and the United States some commitment as to the exchange value of the Japanese yen. As Sir Arthur Salter has suggested, no international conference or formal agreement would be required.[65] After consulting together it would suffice for the participating governments to issue statements that they would cooperate to keep exchange rates within defined limits. If this experiment should prove successful, permanent stabiliza-

59. Cf. Lionel Robbins, "The Problem of Stabilization," Lloyds Bank, *Monthly Review,* April 1935.

60. Cf. "The Banking Bill of 1935 in its Relation to Sound Banking and Business," *The Guaranty Survey,* May 27, 1935.

61. Angas, *The Problems of the Foreign Exchanges,* cited, p. 89; also *The Future of Monetary Policy,* cited, p. 134.

62. Average wholesale prices in the first four months of 1935 have been compared with those of 1929 except in the case of France, where the year 1930 was taken as the basis in the belief that the franc was still undervalued in 1929. It has been assumed also that sterling was 10 per cent overvalued in 1929.

63. For a lucid discussion of the entire problem of determining new exchange rates, cf. Angas, *The Problems of the Foreign Exchanges,* cited, pp. 80-90.

64. Cf. *The Future of Monetary Policy,* cited, p. 137; Sir Arthur Salter, "Conditional Stabilization," *The Economist,* July 13, 1935; Lionel Robbins, "The Problem of Stabilization," cited.

65. Sir Arthur Salter, "Conditional Stabilization," *The Economist,* July 6 and 13, 1935.

tion and the restoration of a free international gold standard would follow.

The re-establishment of international monetary stability is unlikely to be permanent unless the governments of the world are prepared to observe the conditions essential to proper operation of the gold standard. They must be willing to abandon efforts to achieve economic isolation and permit reasonably free movement of goods and capital. They should watch closely the balance of international payments and correct by timely intervention any fundamental disequilibria that may give rise to large transfers of gold. Closer supervision should probably be established over foreign investments, particularly the movement of short-term funds. Above all, the Central Banks should cooperate closely with each other. Probably the Bank for International Settlements offers the best possible agency for such collaboration.[66] The Bank's facilities for clearing international transactions, especially gold movements, and for extending temporary financial assistance might be developed. Full use should also be made of the opportunity it affords for periodic meetings of Central Bank Governors so that information might be interchanged and conflicts of policy eliminated as far as possible. In this connection the question arises as to whether the United States government should not reconsider its previous refusal to permit the Federal Reserve Banks to be officially represented on the board of the World Bank.

CONCLUSION

The chaotic international currency situation of today is more a symptom than a cause of unstable economic and political conditions. It reflects the prevailing tendency toward national self-sufficiency which ignores the value of international trade and places a one-sided emphasis on domestic means of recovery. Progressive economic isolation entails great sacrifices. It compels countries to divert part of their resources from the production of goods and services for which they are best equipped, and devote their energies to producing commodities which can be grown or manufactured more efficiently and cheaply abroad. It involves elimination of the international division of labor which in the past has greatly increased the world's wealth and contributed to higher standards of living. Curtailment of international trade, moreover, accentuates the pressure for imperialist expansion to obtain the raw materials and foreign markets essential to countries of limited economic resources. Autarchy is sometimes promoted as an instrument of domestic stability—as a means of immunizing economic life from disturbing influences abroad. Even if the validity of this contention were conceded, such a policy would succeed only in stabilizing national incomes at much lower levels. In the end, the tendency to shut off international competition—like attempts to curtail domestic competition—places a premium on inefficient production and removes a powerful stimulus to economic progress.

It would be a mistake to regard stabilization of currencies as a panacea for our economic ills. Money is only one of many complex factors affecting the distribution of goods and services. It functions primarily as a means of exchange, thus emancipating the world from primitive methods of barter. Restoration of gold as an international standard of value will therefore create but one of the conditions necessary to a revival of foreign trade.

66. A report prepared for the 1935 conference of the International Chamber of Commerce emphasizes that "the Bank for International Settlements has an important rôle to play in re-establishing normal monetary and financial conditions by developing a system of close relations between Central Banks." Cf. *Monetary Problems*, cited.